DRA

Division of Ratepayer Advocates
California Public Utilities Commission

Dana S. Appling, Director

505 Van Ness Avenue
San Francisco, CA 94102
Phone: (415) 703-2544
Fax: (415) 703-2057

http://dra.ca.gov

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Steve Owens
Western Climate Initiative Allocations Subcommittee Chair
1110 W. Washington St.
Phoenix, AZ 85007

RE: Comments of the Division of Ratepayer Advocates on the Western Climate Initiative's (WCI) Offsets Options Paper

Dear Mr. Owens:

The Division of Ratepayer Advocates (DRA) is an independent division of the California Public Utilities Commission (CPUC) created by state legislation to advocate on behalf of customers of public utilities within the CPUC's jurisdiction. DRA is currently a party to the proceeding before the CPUC and California Energy Commission that is considering issues related to regulation of greenhouse gas emissions in California [R.06-04-009].

DRA appreciates the opportunity to comment on the Allocations Options paper prepared by the WCI Allocations Subcommittee. Offsets can serve as a valuable tool in meeting emission reduction targets in a cost-effective manner. While DRA does have some concerns regarding the challenges of additionality, permanence, leakage, and verification, DRA believes that well-designed standards can mitigate most of these concerns. DRA's responses to the specific questions raised on the Offset Options paper are below.

1. Should the WCI allow offsets as a compliance mechanism?

Yes, with restrictions.

Offsets are well-recognized as valuable flexible compliance mechanisms that can help GHG reduction programs meet their goals in a cost-effective way. Both the European Union's Emissions Trading Scheme (EU ETS) and the Regional Greenhouse Gas Initiative (RGGI)'s cap-and-trade scheme permit the use of offsets to help meet reduction targets. Offsets help to lower the costs to companies, utilities, and consumers in meeting GHG reduction goals. In systems where an allowance price 'safety valve' is in place, offsets can help maintain the reduction targets of the trading system by helping to avoid triggering an economic safety valve.

However, recent investigations of carbon offsets have revealed that many offset projects face serious integrity challenges. These challenges include proving additionality, ensuring permanence, preventing leakage, and verifying that the projects are fulfilling their purported objectives. A March 2007 article in *Business Week*[1] highlighted some of these challenges facing voluntary offset companies. For example, the article claimed that many of the projects supported by TerraPass, one of the leading companies providing voluntary carbon offsets, failed the additionality test. Many of the projects, while considered voluntary, were motivated by other factors besides income from offsets. Several companies admitted that the offsets did not play a role in their decision to go forth with the project. Recent articles in the *New York Times*, the *Economist*, the *Washington Post*,[2] and others echo concerns of offset project integrity.

Furthermore, the uncertainty of actual reductions from offsets may invite the opportunity for leakage, permanence, and other issues. For example, many offsets are granted based upon presumed avoided emissions. The quantity of avoided emissions is calculated based on a theoretical business-as-usual (BAU) scenario. It is often difficult to assess with 100 percent certainty that the BAU scenario is fully accurate. Similarly, offsets granted for sequestering carbon through aforestation have value only if the new forest remains permanent. If, 40 years later, despite sincere attempts to guarantee permanence, a fire destroys the forest, then much of the sequestration value of the forest is lost. Strong quantification/verification guidelines and permanence standards will help mitigate these issues; however, it is unlikely that these challenges can be eliminated entirely.

Part of the problem with the nascent voluntary offset market involves a lack of standards for what counts as an offset, and how to verify those offsets. Many of these issues can be avoided with clear and stringent requirements for offset projects. For example, offsets under the EU ETS must go through a rigorous process to prove the projects meet high additionality, leakage, and permanence standards. While this rigorous verification process reduces the number of projects that qualify, and imposes additional administrative costs, the quality of the successful projects tends to be high. It is therefore imperative that the WCI establish robust standards.[3]

For these reasons, other GHG cap-and-trade schemes plan to limit the role of offsets in meeting targets. Under RGGI, offsets may comprise up to 3.3 percent of an entity's compliance obligation during a control period (if a stage one or stage two trigger occurs, this limit expands to 5 percent and 10 percent). Under the proposed Climate Security Act (the Lieberman-Warner bill), allowances may comprise up to 15 percent of an entity's obligation. These limits are one way to ensure that GHG-emitting entities truly are reducing GHG emissions.

2. Should the WCI allow offsets (only) from projects located within its Partner jurisdictions? Should the WCI allow offsets from projects located outside the WCI (either in the rest of North America or internationally)?

The WCI should permit offsets from outside of its Partner jurisdictions.

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[1] "Another Inconvenient Truth," *Business Week*. 26 March 2007.

[2] Fahrenthold, David and Steven Mufson, "Cost of Saving the Climate Meets Real-World Hurdles," *The Washington Post*, 17 August 2007. "Carbon Connoisseur," *Economist*, 13 August 2007. Revkin, Andrew, "Carbon-Neutral is Hip, but is it Green?" *The New York Times*, 29 April 2007.

[3] Under Assembly Bill 32, California is concurrently considering if and how to permit the use of offsets to reach the State's GHG reduction goals. Because California is a member of the WCI, it is important that there is a harmonization of offset standards and verification guidelines among the California and WCI GHG reduction plans.

There are some valid reasons to limit offsets to the WCI Partner jurisdictions. First, since the WCI is focused on reducing GHG emissions of its Partners, it may want to, out of principle, guarantee that its Partners actually reduce their own emissions. Second, Partners may be able to maintain better oversight and authority over projects within their own jurisdictions.

Also, the Western Climate Initiative is one partner in the fight against global climate change, but cannot by itself halt global warming. Reductions obviously must be made on a grand scale – including within the geographic limits covered by the WCI. While offsets outside of the WCI may allow for cheaper reductions for the WCI, reductions within the geographic confines of the WCI will eventually need to be made.

However, limiting offsets to just WCI jurisdictions will severely limit the number of potential projects, and will likely result in overall higher compliance costs. If offset projects outside of the WCI partner jurisdictions are permitted, it is necessary to clearly define the type of offset projects that qualify and implement a strict verification process to help ensure that projects outside of Partner jurisdictions maintain high integrity.

3. ***Should there be quantitative limits on the use of offsets (perhaps based on their location) to meet compliance obligations?***

Placing quantitative limits is one way to mitigate the potential disadvantages of offsets, and is a strategy proposed by RGGI and the Climate Security Act. In theory, however, a robust verification process would be sufficient to limit the potential disadvantages.

The WCI should consider discounting offsets (so that a ton of offsets counts for less than a ton for compliance obligations). Discounting would be beneficial in two ways. First, it essentially acknowledges that even with stringent standards, some amount of leakage/permanence/additionality problems will likely persist. Discounting can help adjust for reduction losses due to those issues. Second, in a situation where an offset project is economically equivalent to an actual reduction project, discounting will tip the scales toward more straightforward reductions. All other things equal, direct emission reductions by WCI Partners are more desirable than offsets, as direct reductions will help WCI set an example, and also will promote investment in emission-reducing technology within the WCI.

4. ***Should the WCI decide by August 2008 upon an initial list of approved project types, possibly including approved baseline and monitoring methodologies, prior cap-and-trade design? Should the WCI allow offsets from sources capped and regulated by the cap-and-trade system or from indirect emission reductions in sectors covered by the cap-and-trade system?***

DRA has no recommendation regarding whether the WCI should decide upon an initial list of approved project types by August 2008. However, DRA encourages the WCI to draw upon the work already done by RGGI, the EU ETS, and the Climate Security Act in developing guidelines and approving projects.

DRA is unclear regarding what WCI is asking about in Question 4(b). The question seems to imply that some emission reductions may generate both an excess allowance *and* an offset. However, reductions from these sources are already encouraged through the straightforward

market incentive of generating excess allowances that can be sold. Allowing additional reductions to also count as offsets would simply represent a form of double-counting.

5. ***Bilateral linkage: Should the WCI link directly with other, rigorous cap-and-trade programs and allow fungibility of allowances among the two (or more) systems? Unilateral linkage: Should the WCI allow the use of allowances from other, similarly rigorous cap-and- trade programs to be used as a compliance mechanism by capped sources in the WCI?***

   Linking the WCI with other GHG trading systems is appealing in that it would ultimately result in integrated and highly-efficient carbon markets. However, at this stage, the administrative complexity seems daunting, especially given that most proposed GHG trading systems have not yet been implemented. Ideally, the U.S. will soon adopt a national GHG trading system, which may then preempt regional systems, and/or link to international systems. Therefore, the WCI may wish to simply focus on developing a robust regional system as we await the adoption of national GHG reduction legislation.

Thank you for your consideration of these comments.

Sincerely,

Dana S. Appling
Director
Division of Ratepayer Advocates
California Public Utilities Commission
(415) 703-2544
dsa@cpuc.ca.gov